Why we need: Property tax reform

Paul Cheshire

Untangling the council tax knot

Long-term changes are needed to support economic growth

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My first reaction to the introduction of four higher council tax bands in the November budget was that this tactical, short term and ad hoc change addressed, but did not resolve, the most egregious failing in the bodged council tax system: its serious regressiveness. The budget ignored the need to abolish our convenient but damaging stamp duty. Worse, it did not just ignore the fundamental problems of our system of local government finance, but it is possible that one feature of the new higher rates of council tax will actually make the problems worse.

Council tax bands are based on the hypothetical market value of the property in 1991. At the time, properties were assessed using a "drive-by" basis as a stop-gap measure before the tax began in 1993. As a result, for the 6.5 million or so houses and conversions constructed since 1993, valuations are based on what the property is estimated to have been worth in 1991. In England and Scotland, the band values have not changed since implementation (there was a revaluation in Wales in 2003), but in that time house prices over Great Britain as a whole have risen more than five-fold. So those in the most valuable houses in a given local authority have proportionately been paying less – both in respect of their actual house values and relative to their incomes – over time.

That would matter less if house values had risen equally over the last 30 plus years. But house price inflation has also varied greatly across the country. House prices increased by a factor of eight in London but only 3.5 in the north. This means the degree of regressiveness varies greatly across regions, as well as within them.

In the past 30 years, house prices increased by a factor of eight in London but only 3.5 in the north

What the budget's changes missed

Introducing the four new higher bands for houses over £2mn on current valuations does begin to address the terrible regressiveness of council tax but does nothing to address the fact that the valuations have become increasingly disconnected from changing regional patterns of house values. Having a fixed cutoff of £2mn is essentially a tax on living in London and the south-east. Since productivity is higher in the south-east and highest in London, it is a tax on our most productive regional economies.

In addition, the unreformed stamp duty, paid by those buying a property as a proportion of the property price, is a substantial tax on mobility, penalising people moving to where jobs are more productive, but particularly reducing short-distance downsizing or upsizing, meaning our housing stock is less efficiently used. The case for both merging council tax and stamp duty as one property tax and using modern technology to revalue all properties on a regular basis is very strong indeed. But this would need a long-term, strategic vison: not a short-term fix.

Who will benefit, councils or the Treasury?

The budget changes also leave a question unresolved: who will get the extra revenues from the new council tax bands?

At present, the bulk of local government funding – 70% – comes not from council tax but as block grants for particular purposes, for example, to fund education. This has the unintended consequence that a council doesn't benefit if it permits more houses to be built as it doesn't get the extra funding needed to support the needs of the new residents.

The Treasury's wording on this issue is ambiguous. It may be true that the revenues raised will be used to "support funding for local government services" but perhaps just as a lump of revenue to support existing Treasury funding to local government. Unless it is made absolutely clear that the revenues from the higher council tax bands will go directly to the local councils where the houses are situated, then councils in more prosperous (and productive) places will become even more opposed to development. This will not only make our housing affordability crisis worse, but in the medium term it will make it even harder for the most prosperous places to expand their labour forces. The housing market will price out new labour supply even more thoroughly than it does already.

If the government is serious about growth, it should set up a strategic review of both local government funding and property taxes.